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Overview of Governor's 2004-05 Education Budget

Secretary for Education, Richard Riordan

Overview of Education Categorical Programs

California State Auditor's Office

K-12 Education: Local Assistance (6110)

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- **Overview of Governor's 2004-05 Education Budget**

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- **Overview of K-12 Education Categorical Programs**

California State Auditor's Office

K-12 Education: Local Assistance (6110)

I. Governor's Proposed Categorical Funding & Policy Reforms:

Background:

The Auditor General's recently published report on categorical programs identified 113 education categorical programs -- 92 state programs and 21 federal programs -- in 2001-02.¹ Total funding for these programs was estimated at nearly \$17 billion for that fiscal year. [See Appendix A for a list of categorical programs from the Auditor General's report.]

The Auditor General's report makes a number of findings and recommendations about categorical programs in California, including recommendations to the Legislature for considering categorical reform proposals. Specifically, the Auditor General recommends the Legislature do the following when considering categorical block grant proposals:

- Ensure that proposals contain accountability provisions that include a focus toward program results and outcomes.
- Ensure that proposals contain allocation methods that reflect the recipients' need, ability to contribute to program costs, and cost of providing services.
- Determine whether categorical programs involving federal funds are appropriate candidates for consolidation into block grants.
- Consider whether state constitutional principles or court decisions affect proposed changes to categorical programs.

¹ *California Department of Education: The Extensive Number and Breadth of Categorical Programs Challenges the State's Ability to Reform and Oversee Them. State Auditor General, Bureau of State Audits, November 2003.*

Recent Legislation:

In 2003, **SB 525 (Karnette)** proposes to consolidate three school safety programs into a school safety and violence prevention block grant and to consolidate five supplemental instruction programs into a supplemental instruction block grant. In addition, SB 525 states intent to consolidate 12 staff development programs into a teacher preparation and staff development block grant. This bill is currently being held in the Assembly Appropriations Committee.

AB 1650 (Simitian), also introduced in 2003, proposes consolidation of most state funded staff development programs into a single professional development block grant – the Teacher Support and Development (TSD) Block Grant. Funding from all of these programs would be merged in the block grant and allocated by the Superintendent of Public Instruction based on rates for different types of teachers, e.g. teachers with emergency permits or credential waivers, teachers interns, new teachers, etc. LEAs would have to comply with specific standards for quality professional development programs in order to qualify for block grant funds. The State Department of Education would be required to conduct an evaluation of the TSD Block Grant, in order to assess improvements in teacher quality and student achievement, and report its finding to the Legislature. This bill is currently in the Senate Education Committee.

SB 1510 (Alpert), introduced this year, proposes to (1) consolidate three revenue limit “add-on” programs within base revenue limits and (2) consolidate more than 25 categorical programs into eight categorical block grants. These new categorical block grants would be grouped by the following subject areas: pupil retention, school safety, teacher credentialing, professional development, a new targeted instructional improvement grant, Economic Impact Aid, and instructional materials. The statutes for many of the categorical programs would become inoperative effective July 1, 2005. This measure reflects a number of LAO recommendations and proposals tied to the 2004-05 budget and other recent budgets.

2003-04 Budget Proposals:

In 2003-04, Governor Davis initially proposed to consolidate \$5.1 billion for approximately 64 education categorical programs into a single K-12 Instructional Improvement Block Grant. The Governor’s proposal would have repealed nearly all program statutes and regulations governing the 64 programs in the block grant.

As a part of this proposal, the Governor proposed across-the-board reductions that would have had the effect of reducing education programs by approximately \$1.6 billion in 2003-04, or 12 percent overall.

In response to Governor Davis's proposal last year, the LAO developed an alternative categorical block grant program to consolidate 62 categorical programs into five block grant programs, as summarized below.

LAO Proposed Block Grants

- ***Academic Improvement Block Grant (\$2.8 Billion).*** Combines 22 programs that support staff development, instructional or curricular support, or class size reduction. Funds would be available for wide range of general school improvement activities.
- ***Compensatory and Alternative Education Block Grant (\$1.8 Billion).*** Combines 19 programs that fund supplemental services for low-performing students or alternative education settings. Funds could only be spent on these two purposes.
- ***Core Services Block Grant (\$1.4 Billion).*** Consolidates 12 programs that support basic district and classroom costs, including instructional materials and deferred maintenance. Funds would support any of the services currently allowed under existing programs.
- ***Vocational Education Block Grant (\$335 Million).*** Merges 5 vocational education programs that could be used for career counseling, vocational instruction, and vocational components of integrated academic and vocational programs.
- ***Regional Support Block Grant (\$31 Million).*** Consolidates 6 existing county office administered programs that provide technical assistance or coordination of services. Funds would support regional support services as needed by local districts.

A. Governor's Major Categorical Consolidation and Shift Proposal

Governor Schwarzenegger proposes to eliminate separate funding for 22 categorical education programs (listed below) and shift \$2 billion in funding for those programs into revenue limits in 2004-05. Funds shifted into revenue limits would be available to school districts, county offices of education and charter schools for general purposes, but could also be used to continue funding for specific, categorical program purposes if desired.

Local education agencies (LEAs) would receive the same level of overall funding in 2004-05 – specifically 2003-04 funding plus growth and COLAs -- as they would have received under separate categorical program allocations. In the future,

LEAs would receive statutory growth and COLA funding applied to revenue limits.

Under the Governor's proposal, the \$2 billion in categorical funds would be shifted into a new revenue limit "add-on" program, not into "base" revenue limits. Base revenue limits total \$27.8 million in the current year. In addition to base revenue limits, there are currently eight separate revenue limit add-on programs and one other revenue limit program for Necessary Small Schools that account for roughly \$2 billion in state and local funding. [See Appendix B for List of Revenue Limit Programs.] Since funding for revenue limit add-on programs is not counted as a base revenue limit, these new funds would not affect revenue limit equalization calculations.

In creating a new revenue limit add-on program, the Administration proposes to eliminate separate funding for 22 categorical programs in the budget. In addition, the Governor also proposes to eliminate the specific funding requirements for these programs in statute. The Governor does not propose to eliminate the statutes authorizing these programs as a part of consolidation in order to allow local education agencies to continue programs through revenue limit funding.

Programs Governor Proposes to Transfer to Revenue Limit – 2004-05
(Dollars in Millions)

<u>Program</u>	<u>Amount</u>	<u>Program</u>	<u>Amount</u>
Home to School Transportation	\$519.6	Tenth Grade Counseling	\$11.4
School Improvement	396.1	Specialized Secondary Program Grants	5.1
Staff Development Day Buyout	235.7	School Library Materials	4.2
Targeted Instructional Improvement Grant	205.1 ^a	International Baccalaureate	1.1
Instructional Materials Block Grant	175.0	Intersegmental Staff Development	2.0
Supplemental Grants	161.7	Bilingual Teacher Training	1.8
Beginning Teacher Support & Assessment	87.5	At Risk Youth	0.6
Year Round Schools	84.1	Civic Education	0.3
English Language Acquisition Program	53.2	Pupil Residency Verification	0.2
Mathematics & Reading Professional Development	31.7	Teacher Dismissal Apportionment	0.0
Peer Assistance and Review	25.9	Total	<u>\$2,024.4</u>
Dropout Prevention	21.9		

^a. Only includes the voluntary desegregation funding and not court ordered funding.

The Governor utilizes several general criteria in selecting programs for inclusion on the list of programs to be shifted. Generally, programs were selected if:

- (1) funding allocations to districts have been stable historically;
- (2) most districts participate in the program;
- (3) funds are not targeted for special needs students; and
- (4) there are few legal restrictions on the use of funds.

Budget Trailer Bill on Categorical Consolidation/Shift --AB 2824 (Runner):

The Administration is sponsoring AB 2824 (Runner), which contains various statutory provisions tied to the consolidation and shift of 22 categorical programs into the revenue limit program. The bill also includes other education policy initiatives that the Administration deems to be related to its categorical program proposals in the budget. Specifically, this bill:

- Makes the funding provisions of 22 categorical programs inoperative in 2004-05 and allocates funding for those programs as general purpose funding to school districts, county offices of education, and charter schools based on what the LEAs receive from each program in 2003-04.
- Requires school districts to distribute their annual budget and summary to the local news media and public, and publicize the process for seeking budget input from the community, school site leaders, parents and teachers.
- Requires school districts and county offices to annually prepare and publicize a summary of how it will allocate its general purpose funds and to hold hearings on this topic.
- Requires the California Department of Education (CDE), in consultation with the State Board of Education, to classify the performance of school districts according to their API (Academic Performance Index) scores or growth, and establishes an intervention and sanction program to improve district performance.

Budget Control Section 12.70 – Categorical Reform:

Budget Control Section 12.70 is a new control section specifically tied to implementation of the Governor's categorical program shift proposal. Provisions of this control section specify that upon enactment of the Budget Act of 2004, the categorical appropriations for 22 specified categorical programs shall be allocated by the Superintendent of Public Instruction to school districts and county offices as general purpose apportionments, rather than as categorical allocations, in the amounts that would have otherwise been received for these programs.

This control section further specifies that upon enactment of enabling legislation, funds allocated as general purpose funds pursuant to this section will be allocated to LEAs in addition to base revenue limits.

B. LAO Recommendations/Alternatives – General

The LAO generally supports the Governor's proposal to consolidate \$2 billion in existing categorical funds for 22 programs into revenue limits, but proposes a number of modifications designed to improve the Governor's proposal.

The LAO believes that the Governor's categorical consolidation proposal provides a number of benefits that would (1) increase district fiscal and program flexibility; (2) provide administrative savings to districts; (3) focus district activities on outcomes, not program compliance; and (4) clarify state/local relationships.

The LAO has also identified a number of concerns with the Governor's proposal. These concerns include:

- Selection Criteria. LAO suggests a two-pronged criteria for selecting programs that would be appropriate to consolidate in revenue limits:
 - First, is local accountability sufficient to assure that districts won't underinvest in the program? For example, can meaningful participation of parents, teachers and principals hold districts accountable for providing appropriate services to students and schools or are state and federal accountability requirements sufficient to provide these assurances?
 - Second, is the district need for funds measured appropriately by general student attendance? By moving categorical funds into revenue limits, districts will no longer receive any growth funding based upon special populations of students, and instead will receive growth funding based upon changes in general student attendance. For example, will continuing declines in K-12 student growth (rates and numbers) for some districts reflect similar declines in the population of special needs students?
- Transition Issues: The LAO has identified two transition issues that could undermine the goals of the Governor's consolidation-shift program in the short-term.

- First, the LAO is concerned that the Governor's proposal could trigger collective bargaining provisions in district contracts that may obligate new funds shifted into revenue limits to employee salary increases. While these new funds could be used for general purposes, the LAO is concerned that the automatic provisions of existing district bargaining agreements – or possibly provisions built into future agreements – would limit true flexibility for school districts.
- Second, the LAO is concerned about whether school districts could build additional flexibility into their school budget, program planning and accountability systems in any meaningful way in 2004-05 – the first year of the new revenue limit program. Given the parameters of the budget process, the LAO believes school districts will not be able to properly implement consolidation and develop the necessary accountability provisions in their programs and budgets.
- State Information Role is Missing: The LAO believes the Governor's categorical consolidation proposal lacks an important data component that would assist school districts in using general purpose funds effectively.
- Accountability Through Community Involvement: The LAO believes that meaningful community involvement of parents, teachers and principals in the district budgeting process is essential to assuring district accountability as a part of the Governor's consolidation-shift proposal. The LAO was concerned about the lack of details for these provisions in the Governor's proposal when they published their 2004-05 budget analysis. Two budget trailer bills sponsored by the Administration have been introduced since then -- AB 2824 (Runner) and AB 2756 (Daucher). The LAO will update their comments on community involvement and district accountability concerns at this hearing.

Utilizing the selection criteria above, the LAO recommends adding three programs and deleting seven programs from the Governor's consolidation proposal that would have the effect of shifting \$3.8 billion for 18 categorical programs into revenue limits – almost double the level of funding proposed by the Governor. These modifications include:

- Addition of Class Size Reduction Funds (\$1.8 billion). -- The LAO would include \$ 1.7 billion in funds for K-3 Class Size Reduction (CSR) and \$110.2 million for 9th Grade Class Size Reduction to the Governor's proposal. The

LAO believes that given the visibility and popularity of CSR programs to parents and teachers, school districts would have very little incentive to underinvest in these programs. The LAO believes that including CSR programs in the revenue limit would give districts greater flexibility with regards to the 20:1 student-teacher cap, which may reduce costs and make it easier for districts to maintain the programs.

- Addition of Deferred Maintenance (\$250 million) – This program provides funds for major, scheduled repair or replacement projects, separate from ongoing, routine maintenance. School districts match state funds under this program and districts count their local funds toward meeting the three percent major maintenance requirement in state bond acts. The LAO is not supportive of this categorical program as they feel it creates incentives for school districts to underinvest in major maintenance programs._
- Deletion of Funds for Special Needs Students (\$258.3 million) – The LAO recommends that funding included for the English Language Acquisition Program (ELAP) program (\$53.2 million) be removed from the Governor’s proposal. The ELAP program provides instructional support and coordination services for English learner students in grades 4-8. The LAO believes that local accountability for these students is insufficient and therefore these funds should be protected. The LAO also recommends that the voluntary desegregation funds for the Targeted Instructional Improvement Grant (TIIG) program (\$205.1 million) be removed from the Governor’s proposal. (The Governor’s proposal already excludes TIIG funds for court-ordered desegregation.) Alternatively, the LAO recommends that TIIG funds for instructional services be transferred into the Economic Impact Aid (EIA) formula and remaining funds for other “district” services be transferred into revenue limits. [Note: Economic Impact Aid will be heard at the Subcommittee’s April 26th hearing.]
- Deletion of Professional Development Funds (\$384.6 million) -- The Governor’s consolidation-shift proposal would eliminate categorical funding for six professional development programs. The LAO believes there is insufficient local accountability for professional development programs and distributional problems with the Beginning Teacher Support and Assistance (BTSA) program that violate criteria for consolidating programs. Given the importance of teachers in improving student achievement and given the pressure for California to meet the state’s definition of highly qualified teacher by 2005-06, the LAO does not believe that this is a good time to shift separate funding for professional development programs into revenue limits. However, the LAO

does support greater flexibility for professional development programs and makes specific recommendations (see discussion in section below) for consolidating these programs into a Teacher Quality Block Grant.

In response to concerns about transition issues, the LAO makes two additional recommendations intended to limit school district discretion over the use of funds during initial implementation of the Governor's proposal:

- Require districts to use funds consolidated as a revenue limit add-on program as if the categorical programs were in place for 2004-05. The LAO points out that districts can utilize the Mega-Item flexibility contained in Budget Control Section 12.40 to move funds among categorical programs.
- Prohibit school districts from spending funds from the new revenue limit program for district-wide salary increases for the first two years of the program.

Additionally, to address concerns about the lack of data to assist school districts in using general purpose funds effectively, the LAO also recommends that the Legislature appropriate \$500,000 in federal Title VI funds to develop a strategic plan for meeting school district data needs on effective programs.

C. LAO Alternative -- Teacher Quality Block Grant

The 2003-04 budget provides over \$423.4 million in state funding for 11 professional development and support programs for teachers. Most of these programs are administered by CDE, but some programs are administered by the Commission on Teacher Credentialing.

In recent years, the number professional development programs for teachers and other school site staff, as well as the funding for these programs, has declined substantially. The 2001-02 Budget Act included more than \$800 million for teacher quality programs – nearly double the level in the current year budget.

While not the result of a specific reform package on professional development, several of the Governor's 2004-05 budget proposals have a significant effect on professional development and support programs for teachers. As indicated by the table below, the net effect of the Governor's 2004-05 budget proposals on teacher development and support programs is to: (1) shift \$384.6 million in funding for

seven programs into revenue limits; (2) retain \$38.8 million in funding for three small programs; and (3) eliminate \$8.0 million in funding for one program – the Pre-Intern Program.

Governor's Budget Proposals For Teacher Quality Programs	
Teacher-Related Programs	2004-05 Appropriation (In Millions)
Shifted Into Revenue Limits	
Staff Development Buyout Days	\$235.7
Beginning Teacher Support and Assessment	87.5
Intersegmental Staff Development*	2.0
Bilingual Teacher Training	1.8
Mathematics & Reading Professional Development	31.7
Peer Assistance and Review	25.9
Subtotal	\$384.6
Retained as Separate Categorical Programs	
National Board Certification Incentives	\$7.3
Intern Program **	24.9
Paraprofessional Teacher Training Program**	6.6
Subtotal	\$38.8
Programs Eliminated	
Pre-Internship Program* *	(\$8.0)
Subtotal	(\$8.0)
Total, All Programs	\$423.4

* Refers to two programs – College Readiness and Comprehensive Teacher Institutes.

** Administered by the Commission on Teacher Credentialing.

The LAO has strong concerns with the Governor's proposals as they relate to teacher development and support given (1) the importance of teacher quality in improving student learning and (2) the new requirements for teacher quality under the federal No Child Left Behind Act (NCLB).

According to the LAO, the proposal to shift most state funding for teacher-related professional development and support programs into revenue limits would remove incentives for districts to invest in these programs and "would dismantle our state's teacher quality efforts" in meeting the definition of highly qualified teacher under

NCLB. Under this definition, all teachers in California must be highly qualified in the core subjects they teach by the end of the 2005-06 school year.

The LAO is also concerned about the confusing array of programs that have overlapping objectives, are poorly coordinated, and are not effective in directing funds to the teachers with the greatest needs.

In response to these concerns, the LAO recommends that professional development and support programs for teachers be consolidated into a Teacher Quality Block Grant, instead of shifting most funding into revenue limits as proposed by the Governor. This new block grant would:

- Consolidate ten of eleven existing programs, with total funding of \$423.4 million, into a single block grant administered by CDE;
- Allocate funds to LEAs through the consolidated application process based upon the number of new teachers;
- Provide school districts with broad discretion in utilizing block grant funds to meet teacher needs; and
- Eliminate funding for the Pre-Intern Program in 2004-05, as proposed by the Governor, since pre-interns do not meet the definition of highly qualified teachers under NCLB.

As a condition of receiving block grant funds, the LAO recommends that the Legislature require LEAs to provide specific teacher outcome data. In so doing, the LAO further recommends that the Legislature develop a comprehensive teacher information system that includes: (1) establishment of an Instructional Performance Index that measures new teacher quality, teacher retention, professional development, and instructional improvement outcomes; and (2) development of a comprehensive teacher information system – that could be tied to student level data systems currently underway -- to monitor the effectiveness of programs.

II. Governor's Categorical Program Consolidations:

A. School Safety (6110-109-0001, 6110-226-0001, 6110-228-0001)

The Governor proposes to consolidate nearly \$100 million for seven separate school safety programs currently contained in three budget act items into three programs within a single budget item in 2004-05. As indicated by the table below, the Governor proposes to (1) maintain separate funding for the School Safety and

Violence Prevention Block Grant program (\$82.1 million) and the School Safety Plans for New Schools Program (\$3.0 million), and (2) consolidate funding for five competitive school safety programs into a new School Safety Competitive Grant program (\$14.6 million).

Governor's School Safety Competitive Grant Consolidation <i>(In Millions)</i>	
Included Programs	Proposed 2004-05
Gang Risk Intervention Program	\$3.0
School/Law Enforcement Partnership Programs:	
--School Community Policing Partnership	10.0
--School Community Violence Prevention	0.7
--Partnership Mini-Grants/Safe School Planning	0.6
--Conflict Resolution	0.3
Total	\$14.6
Excluded Programs	
School Safety and Violence Prevention Grant Program	\$82.1
School Safety Plans for New Schools Program	3.0
Total	\$85.1
Total, All Programs	\$99.7

The Governor's budget proposal does not change the level of funding for school safety programs overall.

The LAO supports consolidation of school safety programs, but recommends an alternative proposal that merges funding for seven existing programs *and ten school safety mandates* into a single School Safety Block Grant, with the following three components:

- **Per Pupil Formula Grant Based on Grades 8-12 Enrollments (\$112.4 m).**
This formula combines \$82.1 million in existing funding from the School Safety and Violence Prevention Block Grants program and *adds* \$30.3 million in new funding in 2004-05 to cover ten school safety-related state mandates. Funds would be provided to schools on the basis of student enrollments in grade 8-12.

- **High Risk Schools Formula Grant Based on Student Expulsions (\$14.6 m).** This formula would target 20 percent of the schools with the highest safety needs. LAO recommends using mandatory student expulsion data as an indicator of need for this formula. Funds would be distributed to schools on a per pupil basis.
- **Safety Plans for New Schools Grants (\$1.0 m).** This component retains separate funding for the School Safety Plans for New Schools Program, but *reduces* funding by \$2 million – from \$3.0 million to \$1.0 million -- to reflect the actual demand for the program in 2004-05. CDE has had excess funding for this program in recent years, i.e. funding beyond that needed to cover grants for all new schools. In 2002-03, CDE reverted approximately \$2 million for the program.

The LAO's alternative school safety program would cost \$128.0 million in 2004-05, as summarized by the table below. This is \$28.3 million more than the Governor's proposal, which does not provide (actually defers) funding for school safety mandates and other education mandates in 2004-05.

LAO School Safety Alternative	2004-05 (In Millions)
Per Pupil Formula Grants:	\$112.4
<i>School Safety and Violence Prevention Grants (Existing)</i>	<i>82.1</i>
<i>School Safety Related State Mandates (Previously Unfunded)</i>	<i>30.3</i>
High Risk Formula Grants:	\$14.6
<i>Gang Risk Intervention</i>	<i>3.0</i>
<i>School/Law Enforcement Partnership Programs:</i>	
--School Community Policing Partnership	<i>10.0</i>
--School Community Violence Prevention	<i>0.7</i>
--Partnership Mini-Grants/Safe School Planning	<i>0.6</i>
--Conflict Resolution	<i>0.3</i>
Safety Plans for New Schools Grants:	\$1.0
Total, All Programs	\$128.0

In addition to the recommendations contained in their alternative school safety proposal, the LAO further recommends that the Legislature revert \$1.6 million in 2003-04 funds for three competitive grant programs that CDE does not plan to allocate in the current year. These programs include: School Community Violence Prevention, Partnership MiniGrants/Safe School Planning, and Conflict Resolution. Due to reduced staffing and the demands of administering these

programs, CDE did not administer these grant programs last year and does not plan to administer them this year either.

B. Charter Schools. (6110-211-0001 & 6110-128-0001)

Background:

Charter School Funding Model. The 1999 Budget Act Omnibus Education Trailer Bill, Chapter 78, Statutes of 1999 (AB 1115/Strom-Martin), adopted the Charter School Direct Funding Model that provides charter schools with operational funding that is equal to the total funding that would be available to a similar school district servicing a similar pupil population. The Model provides funding to charter schools through:

- **Revenue Limit Funding:** Equal to the state average revenue limit as determined by type (elementary, unified, high school) and distributed through a continuous appropriation.
- **Categorical Program Block Grant Funding:** Provides direct funding to charter schools on a per pupil basis equivalent to what a school district receives for the average student from approximately 28 categorical programs included in the block grant.
- **Separate Categorical Program Funding.** Charter schools must apply directly for approximately 31 other categorical programs and must adhere to all laws governing those programs. These programs include K-3 class size reduction, staff development buyout, child care and after-school programs, supplemental instruction, home-to-school transportation, instructional materials, student assessment, school accountability programs, special education and other state programs.

Approximately 34 categorical programs are excluded from the categorical block grant; of these, charter schools are prohibited from applying for three of these programs – adult education, adults in correctional facilities, and county office fiscal oversight.

Budget Issues:

The Governor's 2004-05 budget proposes major changes to the charter school funding model. Specifically, the Governor proposes to:

- Eliminate the charter school block grant and shift \$21.9 million in funding that would otherwise be available for 28 categorical programs into charter school revenue limits.
- Direct an additional \$24.5 million to charter school revenue limits in addition to the \$2 billion in funding shifted from 22 categorical programs into revenue limits.
- Shift \$14.5 million from the Economic Impact Aid portion of the Charter School Block Grant to the Economic Impact Aid budget item where it will be set aside for charter schools.

Together these proposals would provide a net increase for charter schools of \$24.5 million.

The LAO supports reforms to the charter school funding model, but recommends a different approach than proposed by the Governor in 2004-05. Specifically, the LAO recommends:

- **Revenue Limits:** Shift funding for 17 categorical programs into revenue limits for charter schools, consistent with LAO's recommendation to shift funding for 17 categorical funding into revenue limits for traditional public schools. Make the per pupil funding rate to charter schools consistent with the per pupil funding rate for traditional public schools.
- **Charter School Block Grant:** Retain the block grant, rather than eliminating it as proposed by the Governor, and expand it to include other categorical programs excluded from the block grant through two subgrants:
 - **Base Grant.** Consolidate 21 categorical programs in the base block grant and provide funding to schools based on the average per pupil funding rate for programs. This includes 15 existing programs (those existing programs remaining after shifting 17 programs to revenue limits) and 6 additional

programs previously excluded from the block grant – after school programs, core supplemental instruction, intern program, paraprofessional program, principal training, and ROP/Cs.

- ***Supplemental Disadvantaged Student Grant.*** Consolidate nine programs that target disadvantaged students provide funding to schools based on the average per pupil funding rate for programs. These programs include Economic Impact Aid, which is already a part of the block grant, and eight other programs previously excluded from the block grant – CalSafe, English Language Learners Student Assistance, Gang Risk Intervention, Mandatory Supplemental Instruction, Remedial Supplemental Instruction, National Board Certification, Public School Accountability programs, and TIIG.

In addition, the LAO recommends amending charter school law – specifically Education Code Section 47634(b) -- to specify in statutes all of the categorical programs excluded in the charter school block grant. The LAO cites ongoing confusion about these programs as a basis for this recommendation.

C. American Indian Education Programs (6110-151-0001 & 6110-131-0001)

Existing law establishes two grant programs serving American Indian pupils. The American Indian Early Childhood Education Program provides three year competitive grants directed to improving reading and math competence for American Indian pupils pre-Kindergarten through grade 4. The American Indian Education Centers program funds educational resource centers for American Indian pupils, families and schools.

The Governor proposes to consolidate the appropriations for these two grant programs into a single budget item in 2004-05. Specifically, the Governor proposes to move funds for the American Indian Early Childhood Education Program into the budget item for the American Indian Education Centers program (6110-151-0001).

The Governor's proposal maintains separate appropriations for each of these programs within this budget item and maintains funding at 2003-04 levels -- \$552,000 for American Indian Early Childhood Education Program and \$3,778,000 for American Indian Education Centers.

The LAO has no objection to this recommendation.

III. Governor's Categorical Program Reductions:

In addition to the Governor's proposals to consolidate and/or shift funding for categorical programs, the Governor also proposes to eliminate funding for some categorical programs.

Specifically, the Governor proposes to end funding for seven small categorical programs for a total savings of \$32.6 million in 2004-05. These programs are detailed in the table below.

Program/Item	Program Description	Dollars in Millions
A. Pre-Internship Program (6360-101-0001) Ed. Code 44305)	Provides formal support and assistance to teachers who do not meet the subject matter competency requirement for a teaching credential in order to qualify as a Teacher Intern. The program is administered by the Commission on Teacher Credentialing. [Note: Pre-Intern Teachers do not meet the definition of Highly Qualified Teacher under NCLB, which becomes effective at the end of 2005-06.]	\$8.0
B. Charter Schools Facilities Grant (6610-102-0001) (Ed. Code 47614.5)	Provides funds to charter schools in low-income areas to offset facilities rental and leasing costs. [Note: State bond programs now require school districts to provides charter schools with sufficient Ed. Code states Legislative intent that funds be appropriated through 2003-04.]	\$7.7
C. Local Arts Education Partnerships (6110-177-0001) (Ed. Code 8810-8820)	Provides competitive grants to LEAs to support arts education.	\$6.0
D. Academic Improvement and Achievement (6110-243-0001) (Ed. Code 11020-11024)	Provides competitive grants to LEAs, which are part of regional partnerships with IHEs, to provide academic assistance and services to pupils to prepare them for admission to California State University and University of California. [Note: The program is due to sunset July 1, 2005.]	\$5.0
E. Early Intervention for School Success (6110-163-0001) (Ed. Code 54685 – 54686.2)	Provides competitive grants to LEAs to support best practice models of assessment and early educational intervention for pupils pre-kindergarten through grade 2. The program is administered by the Orange County Office of Education. [Note: This program is due to sunset July 1, 2004.]	\$2.2
F. Healthy Start (6110-200-0001) (Ed. Code 8800-8807)	Provides competitive grants to support health, mental health, social, and other services located at or near school sites.	\$2.0
G. School-to-Career (6110-164-0001) (Ed. Code 53080-53084)	Provides grants to LEAs to support local school-to-career partnerships. [Note: Administration of this program was shifted from the Office of the Secretary for Education to CDE in 2003-04.]	\$1.7

According to the Administration, three of these programs are due to sunset soon-- Academic Improvement and Achievement, Charter Schools Facilities Grant, and Early Intervention for School Success. Three other small programs would be suspended to create general fund savings-- Healthy Start, School-to-Career, and Local Arts Education Partnerships.

In addition, the Administration recommends elimination of the Pre-Internship Program, administered by the Commission on Teacher Credentialing, since teacher pre-interns do not satisfy the definition of highly qualified teachers under the federal No Child Left Behind Act.

The LAO supports the elimination of these seven categorical programs, as proposed by the Governor. The LAO notes that school districts can still utilize pre-interns until the end of 2005-06 when states must fully comply with the requirements for highly qualified teacher under of NCLB.

Budget Trailer Bill Language: The Administration has proposed language to repeal the Pre-Internship Program, but has not proposed trailer bill language to eliminate three other programs that are not due to sunset.

IV. Proposed Budget Flexibility Language

A. Update on Flexibility Language in 2003-04 Budget

The 2003-04 Budget Act reduced funding for a number of education programs, most notably revenue limits, which incurred a 1.2 percent reduction totaling \$350 million. In addition, while revenue limits and special education programs received growth funding, no other education programs received growth funding. Additionally, no education programs, including revenue limits and special education, received COLAs in 2003-04.

Budget trailer bill language contained in AB 1754 (Chapter 227; Statutes of 2003) provides K-12 local education agencies (LEAs) with additional, limited-term flexibility in accessing education reserves and restricted funds, and permits LEAs to use these funds to mitigate revenue limit reductions in 2003-04. These three provisions:

- Reduce the standards for minimum reserves for economic uncertainty for school districts to half of their required levels as of May 1, 2003, thereby

lowering the reserve requirement to a range of .5 to 2.5 percent effective in 2003-04 and 2004-05.

- Reduce school district maintenance reserves from 3 to 2 percent in 2003-04.
- Permit LEAs to access the 2002-03 ending balances for categorical programs – excluding Economic Impact Aid, Special Education, Targeted Instructional Improvement Grants, Instructional Materials, and Public School Accountability Act programs and deferred funding from 2001-02 to 2003-04 – in order to provide local budgeting flexibility in 2003-04.

The California Department of Education has interpreted the flexibility contained in AB 1754 for accessing ending balances very broadly. In a letter to LEAs dated November 12, 2003, the department states that “LEAs’ budget flexibility is not limited to the amount of revenue limit reductions that were incurred for 2003-04.” [See Appendix C for CDE Letter on 2003-04 Budget Flexibility Provisions.]

AB 1754 requires LEAs to report ending balance transfers – programs and amounts – to the Superintendent of Public Instruction. The Superintendent of Public Instruction must report this information to the Joint Legislative Budget Committee in a timely manner.

B. Budget Control Section 12.40 – Mega-Item Flexibility

Background:

The mega-item was developed in the early 1990’s as a means of protecting categorical programs from vetoes. From 1992-93 through 1998-99 funding for more than 30 major categorical programs was appropriated through a single budget act item – referred to as the mega-item – instead of through separate budget items as is currently the case.

To accompany this mega-item structure, budget language in each of these years gave LEAs the authority to transfer funds among categorical programs in the mega-item. These flexibility provisions specified that up to 15 percent of funds could be transferred “out-of” any of these categorical programs and up to 20 percent could be transferred “into” any of these categorical programs.

In 1999-2000, the mega-item was eliminated and separate budget items were re-established for each categorical program. At the same time, Control Section 12.40 was added to the budget to retain the flexibility provisions developed with the mega-item, although the transfer limits were increased to allow transfer of up to 20

percent of funding out of any program and to transfer up to 25 percent into a program in the mega-item. Within this structure, categorical programs could not lose more than 20 percent or gain more than 25 percent in funding.

As a condition of receiving funding, LEAs are required to report annually to the Department of Education on any amounts shifted between categorical programs pursuant to this section. These reports are due by October 8th following the fiscal year they cover. CDE in turn is required to transmit these reports to the Legislature and Department of Finance by February 1st following the fiscal year they cover.

The latest report available from CDE was published in August 2002 and covers the 2000-01 fiscal year. A total of 115 LEAs (114 school districts and one county office of education) reported transfers during this fiscal year. These LEAs comprise approximately 10.5 percent of LEAs statewide. LEAs report utilizing transfers into and out of 26 of the 34 programs eligible for flexibility transfers during 2001-02.

In summary, a total of 11 programs reported net transfers into their programs. Two of these programs – court ordered desegregation and pupil transportation – respectively reported 45 percent and 38 percent of the net transfers “in”. Fifteen programs reported net transfers out. Of these, three programs – Economic Impact Aid, School Improvement and Year Round Education Grants – each comprised approximately 25 percent of the net transfers “out”.

Budget Issues:

Beginning in 1999-2000, Budget Control Section 12.40 allowed LEAs to transfer up to 20 percent of funding out of any program and to transfer up to 25 percent into a program in the mega-item. The 2003-04 budget reduced the level of the mega-item flexibility to 10 percent “out” and 15 percent “in” due to the fact that LEAs were given significant, limited-term flexibility provisions in the current year budget.

The Governor’s 2004-05 budget, continues provisions of Control Section 12.40 at the 2003-04 levels – 10 percent “in” and 15 percent “out”. Still referred to as mega-item flexibility, the control section lists only nine different categorical program items -- down from the 20 included in 2003-04. Control Section 12.40 excludes eleven categorical programs that the Governor proposes to consolidate and shift into revenue limits in 2004-05.

The Administration, through an April Finance Letter, proposes to change the reporting date -- from October 8th to 15th -- for LEAs to report fund shifts pursuant to Budget Control Section 12.40. This change is sought to conform to LEA timelines for reporting year-end fiscal data to CDE.

**V. Financial Status of School Districts
Presentation by Tom Henry, CEO Fiscal Crisis & Management
Assistance Team (FCMAT)**

Background:

Current law requires school districts and county offices of education (LEAs) to file two interim reports annually on their financial status. The first interim report must be completed by LEAs by December 15th and covers the period ending October 31st; the second interim report must be completed by March 17th and covers the period ending January 31st.

As a part of these reports, LEAs must certify whether they are able to meet their financial obligations. The certifications are classified as positive, qualified, or negative.

A positive certification indicates that a LEA will meet its financial obligations for the current and two subsequent fiscal years; whereas a qualified certification indicates a LEA may not meet its financial obligations during this period. Under a negative certification, LEAs are unable to meet their financial obligations in the current year or in the subsequent fiscal year.

County superintendent of schools are required to review the validity of school district certifications and, may reclassify a district certification. The Superintendent of Public Instruction may reclassify any county office of education or school district certification that has been appealed. County Superintendents are required to report certifications for their school districts to the Superintendent of Public Instruction and the State Controller.

First interim reports are due to these state officials by January 15th of each year; second interim reports are due by April 15th.

According to the First Interim Report for 2003-04 – the most recent report available – there are currently seven school districts with negative certifications

and 50 school districts with qualified certifications. As indicated by the table below, the list of districts with negative certifications includes several unified school districts. [See Appendix D for a complete list of districts with negative and qualified certifications.]

Berkeley Unified	Alameda County	\$	90 million budget
Hayward Unified	Alameda County	\$	176 million budget
Livermore Valley Joint Unified	Alameda County	\$	91 million budget
Oakland Unified	Alameda County	\$	443 million budget
West Fresno Elementary	Fresno County	\$	8 million budget
Vallejo City Unified	Solano County	\$	131 million budget
Corning Union Elementary	Tehama County	\$	13 million budget

The school districts with negative certifications listed above will not be able to meet their financial obligations for 2003-2004 or 2004-2005. Two of the school districts on the negative certification list – Oakland Unified and West Fresno Elementary – have received emergency loans from the state. Vallejo Unified is now seeking similar relief from the state.

The numbers of school districts with negative and qualified certifications will reportedly increase when the Second Interim Report for 2003-04 is released in the coming month.

Budget Trailer Bill on School District Budget Oversight – AB 2756 (Daucher):

The Administration is also sponsoring AB 2756 (Daucher), as another budget trailer bill. This measure contains numerous provisions that increase budget oversight for all school districts and for school districts in financial trouble. Specifically, the bill:

- Requires the Superintendent of Public Instruction, the Controller and the Director of the Department of Finance to update the standards and criteria used by county offices and others to evaluate the fiscal condition of districts.
- Revises standing emergency loan procedures for school districts that have become financially insolvent to reflect lessons learned in recent state loan situations.
- Gives county superintendents of schools new authority to conditionally approve school district budgets, or if no budget is submitted, to prepare a budget for the school district.
- Permits the Superintendent of Public Instruction to assign the FCMAT team to review the financial and administrative condition of school districts and charter schools.
- Requires FCMAT to request and review applications to establish regional teams of education finance experts throughout the state.
- Requires school districts to notify the county superintendent of schools and to analyze revisions to the district's current year budget that are necessary to meet the terms of a collective bargaining agreement, prior to – instead of after -- the adoption of that agreement.
- Requires all school districts – not just those with negative of qualified certifications -- to provide the county office of education with financial information about the impact of collective bargaining agreements in current and future budget years.
- Requires the district board to address the county superintendent's fiscal analysis of bargaining agreements at a regularly scheduled board meeting prior to ratification of the agreement.
- Limits the maximum cash settlement a terminated employee may receive to six months of salary instead of eighteen months.

Appendix A

Summary of Categorical Programs Administered by the California Department of Education for Fiscal Year 2001-02

Source: *California Department of Education: The Extensive Number and Breadth of Categorical Programs Challenges the State's Ability to Reform and Oversee Them. California State Auditor, Bureau of State Audits, November 2003.*
<http://www.bsa.ca.gov/bsa/pdfs/2003-107.pdf>

Appendix B

Major Elements of the District Revenue Limit Formula

Legislative Analyst's Office,
Presentation to Senate Budget Subcommittee #1 (Education),
March 15, 2004

http://www.lao.ca.gov/handouts/Education/2004/School_District_Revenue_Limits_031504.pdf

Appendix C

CDE Letter Dated November 12, 2003 2003-04 Budget: Flexibility Provisions

<http://www.cde.ca.gov/fiscal/financial/ab175ltr1704.pdf>

Appendix D

CDE List of LEAs with Negative and Qualified Certifications

Source: California Department of Education, Fiscal Services Division,
<http://www.cde.ca.gov/fiscal/financial/first0304.html>